What the U.S. Tax Cuts and Jobs Act of 2017 means to Canadian and U.S. citizens – changes for U.S. shareholders and non-U.S. corporations

In December 2017, the tax environment in the United States changed significantly with the passing of the Tax Cuts and Jobs Act of 2017 (TCJA). The changes included:

- reductions to individual and corporate tax rates,
- changes to the taxation of U.S. shareholders of non-U.S. corporations, and
- a doubling of the amounts not subject to U.S. Estate and Gift taxes.

These changes affect U.S. citizens who live in the U.S. or Canada, and Canadian residents with U.S. situs assets (for example U.S. vacation properties and U.S. securities).

This issue of As a Matter of Tax looks at the reduction in tax rates and the changes in taxation of U.S. shareholders of non-U.S. corporations.

Reductions to individual tax rates
The Tax Cuts and Jobs Act reduced the top U.S. federal tax rate from 39.6% to 37% and changed when the top rate applies. Here are the new rates and thresholds for a single tax filer:

Federal tax rate	Single US$	C$ equivalent @ 1.27
10%	$0 to $9,525	$0 to $12,097
12%	$9,526 to $38,700	$12,098 to $49,149
22%	$38,701 to $82,500	$49,150 to $104,775
24%	$82,501 to $157,500	$104,776 to $200,025
32%	$157,501 to $200,000	$200,026 to $254,000
35%	$200,001 to $500,000	$254,001 to $635,000
37%	$500,001 and over	$635,001 and over

Here are the Canadian federal tax rates and thresholds:

Federal tax rate	Federal brackets in Canadian dollars
15.0%	$0 to $46,605
20.5%	$46,606 to $93,208
26.0%	$93,209 to $144,489
29.0%	$144,490 to $205,842
33.0%	$205,843 and over

At the federal level, Canadian and U.S. tax rates are similar. U.S. federal rates are higher for income levels greater than US$200,000. However, once provincial taxes are added in, the top marginal rates on regular income range from a low of 47.50% in Saskatchewan to a high of 54% in Nova Scotia. U.S. state income taxes range from 0% to approximately 13%. When the state tax rates are added to the U.S. federal rate, the top marginal tax rate in the U.S. is approximately 50% and only applies to incomes of US$1 million or higher.

In most cases, U.S. citizens who live in Canada will still pay tax at the higher Canadian tax rates, and should get a credit against their U.S. taxes for any Canadian taxes paid.

What the TCJA means for U.S. shareholders of non-U.S. corporations

The Tax Cuts and Jobs Act of 2017 includes new rules and taxes that are designed to encourage U.S. multinational corporations to repatriate funds held in their non-U.S. subsidiaries. These rules also apply to U.S. citizens living in Canada who are shareholders of a non-U.S. corporation.

The transition tax

The first of these new rules is the "transition tax." This tax applies to the retained earnings of non-U.S. corporations, which were not previously subject to U.S. taxes, and that have accumulated since 1986. The transition tax applies to U.S. citizens, residents, and domestic corporations with a 10% or greater stock ownership in a Specified Foreign Corporation (SFC), which includes:

i. foreign corporations where more than 50% of the value of its stock is owned directly or indirectly by U.S. shareholders, and
ii. foreign corporations where a U.S. corporation owns at least 10% of the stock.

A tax rate of approximately 8% to 15.5% applies on these repatriated amounts depending on the nature of the assets in the non-U.S. corporation. The actual tax rate will also vary based on the shareholders' marginal tax rate.

Because of this new rule, U.S. citizens living in Canada may have a deemed income inclusion in 2017 for U.S. purposes and additional U.S. tax to pay. It may be possible to mitigate this tax liability by distributing funds from the corporation to the Canadian resident shareholder in 2018 and apply a portion of the Canadian taxes to the 2017 transitional tax liability.

The global intangible low-taxed income

The second of the new rules is the "Global Intangible Low-taxed Income" or GILTI. Before GILTI, U.S. shareholders were not required to recognize active income earned by a foreign corporation until that income was distributed as a dividend to the U.S. shareholder. Global intangible low-taxed income is a new category of income that requires recognition of a percentage of previously deferred foreign earnings. With GILTI a non-U.S. corporation's profits may be taxable to the U.S. shareholders, unless the corporation has significant tangible assets (depreciable assets) other than land. This new law applies to the non-U.S. corporation's taxation years starting after 2017 (or in certain situations taxation years ending after 2017).

One of the exceptions to the GILTI rule is for high taxed income - income that has been taxed in the non-U.S. corporation at a tax rate higher than 18.9%.

Since most provinces tax the first C$500,000 of active business income of Canadian-controlled private corporations (CCPC) at rates below 18.9%, many small businesses may be caught by this rule, especially professional and service corporations with low levels of tangible assets. The result could be that a U.S. citizen shareholder will be immediately taxed on his or her U.S. tax return for the profits of the CCPC. To match their Canadian and U.S. tax liabilities and optimize their foreign tax credits, individuals subject to this rule could distribute the corporation's income as it's earned.

What effect could the transition tax and GILTI have?
Because of these two rules, people may opt to have assets accumulate personally rather than inside Canadian corporations that are controlled by U.S. citizens. This means that the funds for purchasing insurance policies may now be sourced at the personal rather than corporate level.

The transitional and GILTI rules in the U.S. suggest that, now more than ever, it's imperative that your clients who are U.S. citizens residing in Canada get proper U.S. tax advice and coordinate that advice with their Canadian tax advisors. Without proper advice, these clients could end up paying way more than their fair share of tax.

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